

**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN**

**REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)**

YEAR ENDED SEPTEMBER 30, 2004

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INDEPENDENT AUDITORS' REPORT

Michigan Higher Education Facilities Authority
Lansing, Michigan

October 19, 2004

We have audited the accompanying basic financial statements of the Michigan Higher Education Facilities Authority, a proprietary component unit of the State of Michigan, as of and for the year ended September 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Michigan Higher Education Facilities Authority as of September 30, 2004, and the change in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 19, 2004 on our consideration of the Michigan Higher Education Facilities Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 2 and 3 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Maner, Costerisan & Ellis, P.C.



JENNIFER GRANHOLM

Governor

STATE OF MICHIGAN

DEPARTMENT OF TREASURY

LANSING

JAY B. RISING

State Treasurer

Management's Discussion and Analysis

We are pleased to present the financial statements of the Michigan Higher Education Facilities Authority. The Michigan Higher Education Facilities Authority (the "Authority") was organized under Act 295 of the Michigan Public Acts of 1969. The mission of the Authority is to lower the cost of higher education by providing Michigan's private non-profit educational institutions access to tax-exempt capital. It is the vision of the Authority to be the first choice of capital financing for private non-profit higher educational institutions by being the most efficient and economical source of capital.

The Authority is an agency of the Michigan Department of Treasury and is housed in the Bureau of Bond Finance. The Authority is governed by a nine-member board appointed by the Governor with the advice and consent of the Senate. The Authority is a component unit of the State of Michigan.

The Authority issues or sells tax-exempt bonds in the regional or national public finance markets. The proceeds from these bonds are then lent to private non-profit educational institutions to finance capital projects.

The following is a condensed summary of financial information for the years ended September 30, 2004 and 2003, respectively.

Condensed Financial Information

Category	2004	2003
Total Assets	\$449,411	\$428,113
Total Liabilities	\$0	\$1,332
Total Net Assets	\$449,411	\$426,781
Operating Revenues	\$117,114	\$112,992
Operating Expenses	\$99,373	\$108,265
Operating Income (Loss)	\$17,741	\$4,727
Nonoperating Revenue	\$4,889	\$4,995
Change in Net Assets	\$22,630	\$9,722
Ending Net Assets	\$449,411	\$426,781

Fees charged to its clients fund the operations of the Authority. The fees are based on the outstanding debt of its clients. For fiscal year 2004 the new bond issues exceeded the principal retirement of debt by \$50 million. The operating revenues reflect this additional increase in principal debt outstanding.

Operating expenses decreased 8% from the previous fiscal year. The charges for the Attorney General services were lower than last year. Another reduction was in the expense related to the publication of notices. Effective for fiscal year 2004, the Authority board shifted the expense related to the publication of notices from the Authority to the college client.

For 2004, the Authority made a positive contribution in the amount of \$22,630 to the net assets. This was an increase of 132% from the previous fiscal year. The increase in fee revenue and the lower operating expenses drove this substantial increase. The financial position of the Authority is stable with the intention of collecting sufficient revenues to cover the operations of the Authority.

Economic conditions were favorable for the Authority this fiscal year. The Authority's clients realized attractive interest rates on their loans. The Authority issued over \$97 million in debt this past fiscal year with interest rates varying from 1.05% to 5.00%.

**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2004**

ASSETS

CURRENT ASSETS:

Amounts due from state treasurer	\$ 418,499
Other current assets:	
Fees receivable	<u>30,912</u>

TOTAL ASSETS	<u><u>\$ 449,411</u></u>
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LIABILITIES AND NET ASSETS

NET ASSETS:

Unrestricted	<u><u>\$ 449,411</u></u>
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MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
STATEMENT OF ACTIVITIES
YEAR ENDED SEPTEMBER 30, 2004

	<u>Expenses</u>	<u>Charges for services</u>	<u>Net (expense) revenue and change in net assets</u>
Functions/Programs:			
Primary Government			
Business type activities:			
Higher Education Facilities Authority	<u>\$ 99,373</u>	<u>\$ 117,114</u>	\$ 17,741
General revenues:			
Investment income			<u>4,889</u>
CHANGE IN NET ASSETS			22,630
NET ASSETS:			
Beginning of year			<u>426,781</u>
End of year			<u>\$ 449,411</u>

MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED SEPTEMBER 30, 2004

OPERATING REVENUES:

Authority fees	\$ 117,114
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OPERATING EXPENSES:

Personnel services	3,352
Purchased professional and technical services	94,309
Other expenses	1,712

Total operating expenses	99,373
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Operating income	17,741
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NONOPERATING REVENUES:

Investment income	4,889
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CHANGE IN NET ASSETS	22,630
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NET ASSETS:

Beginning of year	426,781
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End of year	\$ 449,411
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MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
STATEMENT OF CASH FLOWS
YEAR ENDED SEPTEMBER 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers	\$ 114,959
Payments to suppliers	<u>(100,705)</u>
Net cash provided by operating activities	<u>14,254</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest and investment income (non program)	4,889
Advances to state treasurer	<u>(19,143)</u>
Net cash used by investing activities	<u>(14,254)</u>

NET INCREASE IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS:

Beginning of year	<u> </u>
End of year	<u><u>\$ </u></u>

**RECONCILIATION OF OPERATING INCOME TO NET CASH
PROVIDED (USED) BY OPERATING ACTIVITIES:**

Operating income	<u>\$ 17,741</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Changes in assets and liabilities:	
Fees receivable	(2,155)
Accounts payable	<u>(1,332)</u>
Total adjustments	<u>(3,487)</u>
Net cash provided by operating activities	<u><u>\$ 14,254</u></u>

MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Michigan Higher Education Facilities Authority (the “Authority”) was organized under Act No. 295 of the State of Michigan Public Acts of 1969 to issue tax-exempt bonds and lend the proceeds to nonpublic, nonprofit institutions of higher education within the State for capital improvements.

During 1992, oversight responsibility for the Authority was transferred from the Department of Education to the Department of Treasury, under Executive Order 1992-2.

The Authority is a component unit of the State of Michigan and is reported as such in the State of Michigan Comprehensive Annual Financial Report.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board Statements No. 14 and No. 39. These criteria include oversight responsibility, accountability for fiscal matters, scope of public services and special financing relationships.

In July 2002, an executive order was issued which combined the Authority’s administrative staff with the administrative staff of several similar authorities into a single work unit under the direction and supervision of the State Treasurer.

B. Financial Statements

The financial statements (i.e., the statement of net assets and the statement of activities, statement of revenues, expenses and changes in net assets and statement of cash flows) report all activities of the government. The Authority is considered a business type activity and has no component units.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include charges to customers who use, or directly benefit from services or privileges provided by a given function or segment.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The Authority is accounted for as a proprietary fund. A proprietary fund is used to account for operations:

- a) That are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or;

MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- b) Where the governing body has decided periodic determination of revenues and expenses and net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Proprietary funds are reported using the “economic resources measurement focus” and the “accrual basis of accounting”. Revenues are recognized when earned and expenses are recognized when the materials, services, or benefits are received. Service fees and other fees and charges are recorded as income when earned, and the associated administrative expenses are recorded as incurred.

Designated trustees maintain separate accounting records pertaining to each individual bond issue for each participating facility. Assets managed by the trustees for each facility are restricted for payment of bond principal and interest and approved construction expenditures except for certain investment income which may be returned to the facility. None of the assets or liabilities held by the trustees are reflected in the Authority's financial statements, as more fully described in Note 2.

Bond proceeds are retained by the trustees to fund interest costs and principal payments during the period of construction. After the construction period, interest and principal payments are funded by regular loan payments from the facilities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Amounts reported as *program revenues* include charges to customers, services, or privileges provided. Likewise, general revenues include unrestricted investment income.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for services. Operating expenses of the Authority include the cost of services, administrative expenses, and the depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Assets, Liabilities, and Net Assets

Cash and Cash Equivalents: Cash and cash equivalents include deposits with financial institutions and other highly liquid short-term investments with original maturities of less than 3 months used for cash management rather than investing activities. As of September 30, 2004, the Authority did not have any cash or cash equivalents.

MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY
A COMPONENT UNIT OF THE STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Concluded)

D. Assets, Liabilities, and Net Assets (Concluded)

Fees Receivable - Annual service fees due from various higher education institutions throughout Michigan are recorded on a monthly basis. Because of the Authority's favorable collection experience, no allowance for uncollectible accounts is considered necessary.

Use of Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 2 - UNRECORDED LIMITED OBLIGATION DEBT

The Authority has certain bonds outstanding. The trustee, fiscal agent, registrar, and paying agent functions for the defeased bonds are performed by an Authority designated trustee. Because these obligations are, in substance, debts of other entities, the liabilities and related assets are not reflected in the Authority's financial statements. All bonds are limited obligations of the Authority and do not constitute a general obligation of the State of Michigan or the Authority.

For bond issues, which have been defeased in-substance, the proceeds of new bonds have been placed in irrevocable trust to provide for all future debt service payments on the old bonds. Economic gains and accounting gains and losses upon in-substance defeasance inure to the benefit of the facility for which the bonds were issued and accordingly are not reflected in the Authority's financial statements.

The defeased, defeased and total outstanding bonds as of September 30, 2004 follows:

Defeased	\$ 24,040,000
Defeased	<u>384,010,000</u>
	<u><u>\$ 408,050,000</u></u>

NOTE 3 - TRANSACTIONS WITH OTHER STATE AGENCIES

The Authority has contracted with the Michigan State Hospital Finance Authority (a similar authority for non-profit hospitals also under the Department of Treasury) for certain administrative services. The contract amount was \$30,000 for the year ended September 30, 2004.

The Authority is also charged by other state agencies and departments for certain accounting, auditing and legal services. These fees were approximately \$59,300 for the year ended September 30, 2004. No amounts were due the other state agencies and departments for these charges as of September 30, 2004.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Michigan Higher Education Facilities Authority
Lansing, Michigan

October 19, 2004

We have audited the basic financial statements of the Michigan Higher Education Facilities Authority, a proprietary component unit of the State of Michigan, as of and for the year ended September 30, 2004, and have issued our report thereon dated October 19, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Authority and management and is not intended to be and should not be used by anyone other than these specified parties.